

PERAC AUDIT REPORT



Salem Contributory Retirement System

JAN. 1, 2001 - DEC. 31, 2004 / PERAC 04: 11-080-10



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

DOMENIC J. F. RUSSO, *Chairman* | A. JOSEPH DeNUCCI, *Vice Chairman*

JOSEPH E. CONNARTON, *Executive Director*

HENRY G. BRAUER | KENNETH J. DONNELLY | JAMES M. MACHADO | DONALD R. MARQUIS | THOMAS TRIMARCO

November 18, 2005

The Public Employee Retirement Administration Commission has completed an examination of the **Salem** Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, **2001** to December 31, **2004**. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in Note 3 of this report.

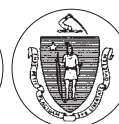
In our opinion, the financial records and management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners **James Ryan and James Tivnan** who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



Salem Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

1. Annual Statement:

Based upon inspection of the Annual Statements filed by the Board for the four year audit period, it was determined that certain line item amounts contained in the Annual Statement did not match the detailed supporting schedules. Variances were found in investment income, and realized and unrealized gains and losses. While all cash accounts were listed in Schedule 1, the income attributed to these as recorded in the Investment Income Statement and as listed in the supporting schedules provided by the custodian could not be reconciled. The Annual Statement does agree with the balances on the general ledger. However, the information provided in Schedule 6, which is a comprehensive summary report of investments owned, did not agree with the corresponding information reported on other statements and schedules included in the annual report. The discrepancy is particularly apparent in comparison to the alternative investments. The Salem Retirement Board relies on financial information provided by the custodian. This information is subject to delay and adjustments retroactive to the prior period are not uncommon.

Recommendation:

As a sole source of information to third parties, the Annual Statement and supporting schedules must be in agreement allowing readers to make an accurate assessment of the system's financial condition without having to reference the general ledger. Prior to submission of the Annual Statement, a review process should be established to ensure all entries on the Annual Statement agree with the detailed supporting schedules using the PERAC Annual Statement Guide published each year. Differences in custodian-provided schedules should be corrected, if needed, and reconciled to the general ledger prior to submission of the Annual Statement. All income from cash accounts must be listed on Schedule 1 and agreed to the amount reported in the Annual Statement. All receipts and investment income need to be reported in summary form on Schedule 6 and agreed to the general ledger. All disbursements should be agreed to their respective supporting schedules. Investment transactions such as realized and unrealized gains and losses, as well as categories of investment income, should agree to their respective statement or supporting schedule.

Board Response:

We have discussed this problem with our custodial bank and they have met with PERAC and are working on resolving this issue. The main problem is with the alternative investments, and even one of the auditors commented how difficult and time consuming it is to get the needed information from the statements received from some of these managers. Once this information is available, rest assured that all categories of investment income will agree to the statements and supporting schedules.

Salem Retirement System

STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

FOR THE PERIOD ENDING DECEMBER 31,				
ASSETS	2004	2003	2002	2001
Cash	\$2,702,532	\$2,202,719	\$1,924,244	\$1,648,094
Short Term Investments	1,197,595	1,286,146	2,423,855	2,082,106
Fixed Income Securities (at book value)	12,013,809	12,910,113	25,072,859	24,876,789
Equities	7,981,103	6,431,733	13,637,259	17,019,958
Pooled Domestic Equity Funds	33,922,048	32,662,393	5,980,646	7,561,075
Pooled International Equity Funds	7,173,401	5,900,550	4,517,105	5,435,934
Pooled Alternative Investment Funds	7,337,383	7,276,838	5,860,720	6,802,863
Pooled Real Estate Funds	6,028,433	4,504,898	3,896,007	4,575,398
Interest Due and Accrued	159,664	171,367	353,946	393,624
Accounts Receivable	292,474	111,736	148,151	265,796
Accounts Payable	(83,354)	(288,427)	(115,722)	(20,503)
TOTAL	<u>\$78,725,088</u>	<u>\$73,170,067</u>	<u>\$63,699,071</u>	<u>\$70,641,135</u>
FUND BALANCES				
Annuity Savings Fund	\$25,177,803	\$23,713,014	\$24,580,318	\$22,879,856
Annuity Reserve Fund	9,512,021	9,396,400	7,003,853	6,962,351
Pension Fund	(4,048,970)	(2,151,324)	124,859	1,726,507
Military Service Fund	730	726	718	708
Expense Fund	0	0	0	0
Pension Reserve Fund	48,083,503	42,211,251	31,989,323	39,071,711
TOTAL	<u>\$78,725,088</u>	<u>\$73,170,067</u>	<u>\$63,699,071</u>	<u>\$70,641,135</u>

Salem Retirement System

STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Pension Reserve Fund	Total All Funds
Beginning Balance (2001)	\$21,406,276	\$6,804,197	\$3,856,367	\$695	\$0	\$41,660,387	\$73,727,923
Receipts	2,941,010	209,658	5,312,532	13	608,234	(2,725,712)	6,345,735
Interfund Transfers	(969,534)	968,329	(135,832)	0	0	137,036	0
Disbursements	(497,897)	(1,019,834)	(7,306,560)	0	(608,234)	0	(9,432,524)
Ending Balance (2001)	22,879,856	6,962,351	1,726,507	708	0	39,071,711	70,641,135
Receipts	3,056,755	204,013	6,018,021	10	711,756	(7,082,389)	2,908,166
Interfund Transfers	(911,732)	911,732					0
Disbursements	(444,561)	(1,074,243)	(7,619,670)	0	(711,756)	0	(9,850,230)
Ending Balance (2002)	24,580,318	7,003,853	124,859	718	0	31,989,323	63,699,071
Receipts	2,890,067	247,028	6,029,517	7	662,159	10,221,929	20,050,707
Interfund Transfers	(3,354,962)	3,354,962	0	0	0	0	0
Disbursements	(402,409)	(1,209,444)	(8,305,699)	0	(662,159)	0	(10,579,711)
Ending Balance (2003)	23,713,014	9,396,400	(2,151,324)	726	0	42,211,251	73,170,067
Receipts	3,098,639	287,084	7,271,690	4	750,016	5,869,122	17,276,556
Interfund Transfers	(1,190,343)	1,183,812	3,401	0	0	3,130	0
Disbursements	(443,507)	(1,355,275)	(9,172,737)	0	(750,016)	0	(11,721,535)
Ending Balance (2004)	<u>\$25,177,803</u>	<u>\$9,512,021</u>	<u>(\$4,048,970)</u>	<u>\$730</u>	<u>\$0</u>	<u>\$48,083,503</u>	<u>\$78,725,088</u>

Salem Retirement System

STATEMENT OF INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Annuity Savings Fund:				
Members Deductions	\$2,586,466	\$2,556,945	\$2,580,213	\$2,397,067
Transfers from other Systems	287,111	53,991	70,273	100,612
Member Make Up Payments and Redeposits	89,341	56,524	95,123	53,586
Investment Income Credited to Member Accounts	<u>135,721</u>	<u>222,607</u>	<u>311,145</u>	<u>389,745</u>
Sub Total	<u>3,098,639</u>	<u>2,890,067</u>	<u>3,056,755</u>	<u>2,941,010</u>
Annuity Reserve Fund:				
Investment Income Credited Annuity Reserve Fund	<u>287,084</u>	<u>247,028</u>	<u>204,013</u>	<u>209,658</u>
Pension Fund:				
3 (8) (c) Reimbursements from Other Systems	117,094	95,603	111,637	87,902
Received from Commonwealth for COLA and Survivor Benefits	536,735	428,680	985,584	478,010
Prin Adj Account Amort Gain	0	0	0	135,832
Pension Fund Appropriation	<u>6,617,862</u>	<u>5,505,234</u>	<u>4,920,800</u>	<u>4,610,788</u>
Sub Total	<u>7,271,690</u>	<u>6,029,517</u>	<u>6,018,021</u>	<u>5,312,532</u>
Military Service Fund:				
Contribution Received from Municipality on Account of Military Service	0	0	0	0
Investment Income Credited Military Service Fund	<u>4</u>	<u>7</u>	<u>10</u>	<u>13</u>
Sub Total	<u>4</u>	<u>7</u>	<u>10</u>	<u>13</u>
Expense Fund:				
Investment Income Credited to Expense Fund	<u>750,016</u>	<u>662,159</u>	<u>711,756</u>	<u>608,234</u>
Sub Total	<u>750,016</u>	<u>662,159</u>	<u>711,756</u>	<u>608,234</u>
Pension Reserve Fund:				
Federal Grant Reimbursement	14,635	31,120	59,651	9,337
Interest Not Refunded	3,130	3,072	3,780	2,992
Pension Reserve Appropriation	0	150,000	0	150,000
Excess Investment Income	<u>5,851,357</u>	<u>10,037,736</u>	<u>(7,145,819)</u>	<u>(2,888,041)</u>
Sub Total	<u>5,869,122</u>	<u>10,221,929</u>	<u>(7,082,389)</u>	<u>(2,725,712)</u>
TOTAL RECEIPTS	<u>\$17,276,556</u>	<u>\$20,050,707</u>	<u>\$2,908,166</u>	<u>\$6,345,735</u>

Salem Retirement System

STATEMENT OF DISBURSEMENTS

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

FOR THE PERIOD ENDING DECEMBER 31,				
	2004	2003	2002	2001
Annuity Savings Fund:				
Refunds to Members	\$341,103	\$161,048	\$364,483	\$235,433
Transfers to other Systems	<u>102,404</u>	<u>241,360</u>	<u>80,078</u>	<u>262,463</u>
Sub Total	<u>443,507</u>	<u>402,409</u>	<u>444,561</u>	<u>497,897</u>
Annuity Reserve Fund:				
Annuities Paid	1,339,038	1,197,694	1,040,407	1,015,487
Option B Refunds	<u>16,236</u>	<u>11,750</u>	<u>33,836</u>	<u>4,346</u>
Sub Total	<u>1,355,275</u>	<u>1,209,444</u>	<u>1,074,243</u>	<u>1,019,834</u>
Pension Fund:				
Pensions Paid				
Regular Pension Payments	6,272,261	5,532,260	4,819,607	4,682,268
Survivorship Payments	464,813	467,567	486,663	472,011
Ordinary Disability Payments	129,197	125,572	132,273	143,724
Accidental Disability Payments	1,488,077	1,438,846	1,334,265	1,272,186
Accidental Death Payments	493,094	449,809	447,440	446,104
Section 101 Benefits	47,957	47,596	52,554	43,631
3 (8) (c) Reimbursements to Other Systems	197,924	169,129	271,099	170,445
COLA's Paid	<u>79,414</u>	<u>74,921</u>	<u>75,768</u>	<u>76,191</u>
Sub Total	<u>9,172,737</u>	<u>8,305,699</u>	<u>7,619,670</u>	<u>7,306,560</u>
Military Service Fund:				
Return to Municipality for Members Who Withdrew Their Funds		<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:				
Board Member Stipend	18,000	18,000	18,000	13,521
Salaries	151,880	137,206	134,131	128,447
Legal Expenses	4,321	8,813	7,195	17,496
Fiduciary Insurance	8,632	0	0	0
Service Contracts	31,229	17,477	0	0
Rent Expense	15,279	16,395	0	0
Travel Expenses	2,730	2,140	3,397	11,716
Administrative Expenses	70,264	99,008	103,791	98,532
Furniture and Equipment	10,923	4,934	2,549	3,658
Management Fees	347,923	259,298	351,796	276,591
Custodial Fees	37,834	51,389	43,897	32,773
Consultant Fees	<u>51,000</u>	<u>47,500</u>	<u>47,000</u>	<u>25,500</u>
Sub Total	<u>750,016</u>	<u>662,159</u>	<u>711,756</u>	<u>608,234</u>
TOTAL DISBURSEMENTS	<u>\$11,721,535</u>	<u>\$10,579,711</u>	<u>\$9,850,230</u>	<u>\$9,432,524</u>

Salem Retirement System

INVESTMENT INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Investment Income Received From:				
Cash	\$45,924	\$120,137	\$122,037	\$379,654
Short Term Investments	0	0	0	0
Fixed Income	809,031	1,744,165	1,801,318	1,608,513
Equities	89,620	250,186	198,387	208,730
Pooled or Mutual Funds	57,524	568,164	871,405	1,116,244
Commission Recapture	0	8,872	8,884	2,402
TOTAL INVESTMENT INCOME	<u>1,002,098</u>	<u>2,691,524</u>	<u>3,002,031</u>	<u>3,315,543</u>
Plus:				
Realized Gains	658,038	2,760,967	601,397	1,092,566
Unrealized Gains	12,064,842	8,858,737	3,528,012	4,637,546
Interest Due and Accrued on Fixed Income Securities - Current Year	159,664	171,367	353,946	393,624
Sub Total	<u>12,882,544</u>	<u>11,791,071</u>	<u>4,483,354</u>	<u>6,123,736</u>
Less:				
Paid Accrued Interest on Fixed Income Securities	(112,660)	(291,924)	(210,364)	(202,070)
Realized Loss	(638,347)	(831,428)	(3,321,379)	(1,464,331)
Unrealized Loss	(5,938,085)	(1,835,759)	(9,478,914)	(9,032,118)
Interest Due and Accrued on Fixed Income Securities - Prior Year	(171,367)	(353,946)	(393,624)	(410,144)
Sub Total	<u>(6,860,460)</u>	<u>(3,313,057)</u>	<u>(13,404,281)</u>	<u>(11,108,662)</u>
NET INVESTMENT INCOME	<u>7,024,183</u>	<u>11,169,538</u>	<u>(5,918,896)</u>	<u>(1,669,383)</u>
Income Required:				
Annuity Savings Fund	135,721	222,607	311,145	389,745
Annuity Reserve Fund	287,084	247,028	204,013	209,658
Military Service Fund	4	7	10	13
Expense Fund	750,016	662,159	711,756	608,234
TOTAL INCOME REQUIRED	<u>1,172,826</u>	<u>1,131,801</u>	<u>1,226,924</u>	<u>1,207,651</u>
Net Investment Income	<u>7,024,183</u>	<u>11,169,538</u>	<u>(5,918,896)</u>	<u>(1,669,383)</u>
Less: Total Income Required	<u>1,172,826</u>	<u>1,131,801</u>	<u>1,226,924</u>	<u>1,207,651</u>
EXCESS INCOME TO THE PENSION RESERVE FUND	<u>\$5,851,357</u>	<u>\$10,037,736</u>	<u>(\$7,145,820)</u>	<u>(\$2,877,034)</u>

SALEM Retirement System

STATEMENT OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED*
Cash	\$2,702,532	3.45%	100
Short Term	1,197,595	1.53%	100
Fixed Income	12,013,809	15.33%	40 - 80
Equities	7,981,103	10.19%	40
Pooled Domestic Equity Funds	33,922,048	43.29%	
Pooled International Equity Funds	7,173,401	9.15%	
Pooled Alternative Investment Funds	7,337,383	9.36%	
Pooled Real Estate Funds	6,028,433	7.69%	
Pooled Domestic Balanced Funds	0	0.00%	
GRAND TOTALS	<u>\$78,356,304</u>	<u>100.00%</u>	

For the year ending December 31, 2004, the rate of return for the investments of the Salem Retirement System was 10.02%. For the five-year period ending December 31, 2004, the rate of return for the investments of the Salem Retirement System averaged 3.80%. For the nineteen-year period ending December 31, 2004, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the Salem Retirement System was 8.64%.

Salem Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

The Salem Retirement System submitted the following supplementary investment regulations, which were approved by PERAC on:

April 7, 2000

16.08(2) In accordance with PERAC Investment Guideline 99-2, the Salem Retirement Board may invest in the Freedom Capital Equity Style Fund. Proceeds will come from 40% of the Board's current equity account with Freedom Capital Management. The Style Fund has the same investment strategy and invests in the same universe of stocks as the managed account. The difference is that it invests in either of two indexes (the S&P Barra Growth Index or the S&P Barra Value Index) rather than in individual securities. In so doing, management fees and other costs to the Board are reduced.

December 10, 1999

16.08(1) In accordance with PERAC Investment Guideline 99-2, the Salem Retirement Board may amend its domestic fixed income management mandate with Freedom Capital Management Corporation to allow the manager to opportunistically invest up to 15% of its core portfolio in securities rated either Ba by Moody's or BB by Standard and Poor's.

July 11, 1996

20.03(1) Equity investments shall not exceed 60% of the portfolio valued at market, including international equities which shall not exceed 15% of the portfolio valued at market.

June 6, 1996

20.03(2) At least 40% but no more than 80% of the total portfolio valued at market shall consist of fixed income investments with a maturity of more than one year including Yankee Bonds which shall be limited to 10% of the total fixed income portfolio valued at market.

January 25, 1996

840 CMR 21.00: Prohibited Investments

(3) Futures Contracts other than as follows:

- (a) Forward Currency Contracts may be written against securities in the international portfolio by an investment advisor registered under the Investment Advisors Act of 1940 and who has been granted a waiver from PERAC for international investments.
- (b) Forward Currency Contracts may be written against securities in the international portfolio to a maximum of twenty-five percent (25%) of the international portfolios non-dollar holdings at market value. Speculative currency positions unrelated to underlying portfolio holdings are strictly prohibited.

Salem Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (CONT'D)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

August 4, 1994

20.03(1) Equity investments shall not exceed 50% of the portfolio valued at market, including international equities which shall not exceed 10% of the portfolio valued at market.

20.04(1) United States based corporations and equities of foreign corporations.

20.07(5) Equity investments shall be made only in securities listed on a United States stock exchange, traded over the counter in the United States, or listed and traded on a foreign exchange.

November 17, 1989

20.03(1) Equity investments shall not exceed 50% of the total book value of the portfolio at the time of purchase.

August 16, 1989

16.02(3) A board may incur expenses for consultant services, which shall be limited to setting of investment objectives, selection and on-going review of qualified investment advisors and performance evaluation, and investment advice or management of the funds of the system by a qualified investment advisor and may charge such expenses against earned income from investments provided that such expenses shall not exceed in any one year:

(a) 1% of the value of the fund for the first \$5 million, and

(b) 0.5% of the value of the fund in excess of \$5 million

16.02(4) The employment of a consultant must take place by a written contract, negotiated between the consultant and the board. Such contract shall state the terms and conditions of the agreement, including but not limited to, termination provisions, length and fees. All such contracts must be forwarded to PERAC.

November 17, 1988

(1) Real estate investments shall not exceed 2% of the total book value of the portfolio at the time of purchase and shall consist of real estate trusts and partnerships, provided that:

(a) trust participants or limited partners do not participate in the selection of the trustees or general partners and should a limited partner be required to participate in the selection of a general partner, prior to any participation by the board, the board shall consult with PERA to determine the appropriate course of action, and (b) such trustees or general partners retain authority in the decision making process, and

(c) should an investment in a trust or limited partnership result in the direct ownership of real estate or mortgage indebtedness, such shall be permitted only until such time as divestiture of said trust or limited partnership is prudent.

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 1 - THE SYSTEM

The plan is a contributory defined benefit plan covering all Salem Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Voluntary contributions, redeposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Salem Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

July 19, 1990

School employees must work a minimum of 25 hours per week to be eligible for membership. Full time school employees who are members will be given 1 year of creditable service for 10 months employment.

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

February 4, 1986

MEMBERSHIP City of Salem; Salem Redevelopment Authority; Salem Housing Authority, North Shore Regional Vocational School District; Salem-Beverly Water Board; South Essex Sewerage employees shall become members of the system when hired as directed by Chapter 32, section 3.

MEMBERSHIP: Part-time employees shall become members by meeting qualification of Chapter 32 and rules of retirement board as follows: 20 hrs. per week, 39 weeks per year give 1/2 yr. creditable service.

MEMBERSHIP: Employees of temporary nature found to be ineligible for membership in system upon becoming permanent employee shall have privilege of purchasing past service, so allowed by board.

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five person Board of Retirement consisting of the Treasurer who shall be a member ex officio, a second member appointed by the governing authority, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Ex officio Member: Bruce M. Guy

Appointed Member: Louise E. Conrad Term Expires:

Elected Member: John H. Burke Jr. Term Expires: 12/05/05

Elected Member: Dennis E. Flynn Term Expires: 6/05/07

Appointed Member: Katherine O'Leary Term Expires: 11/01/06

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board and are then submitted to the PERAC Actuary for verification prior to payment. All expenses incurred by the System must be approved by at least two members of the Board.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

Treasurer - Custodian:)	Fiduciary Liability
Ex officio Member:)	\$10,000,000
Elected Member:)	

Appointed Member:)	Commercial Crime/Dishonesty
Staff Employee:)	\$1,000,000

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by Buck Consultants as of January 1, 2003.

The actuarial liability for active members was	\$67,985,036
The actuarial liability for retired members was	<u>69,126,523</u>
The total actuarial liability was	137,111,559
System assets as of that date were	76,438,885
The unfunded actuarial liability was	<u>\$60,672,674</u>
 The ratio of system's assets to total actuarial liability was	 55.7%
As of that date the total covered employee payroll was	\$31,089,195

The normal cost for employees on that date was 8.00% of payroll

The normal cost for the employer including estimated administrative expenses was 6.00% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.50% per annum
Rate of Salary Increase: 5.50% per annum

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2003

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2003	\$ 76,438,885	\$ 137,111,559	\$ 60,672,674	55.7%	\$ 31,089,195	195.16%
1/1/2001	\$ 73,727,923	\$ 117,334,727	\$ 43,606,804	62.8%	\$ 29,072,197	149.99%
1/1/1999	\$ 68,563,143	\$ 111,294,953	\$ 42,731,810	61.6%	\$ 25,411,629	168.16%
1/1/1997	\$ 51,236,360	\$ 82,440,774	\$ 31,204,414	62.1%	\$ 22,930,939	136.08%
1/1/1994	\$ 41,074,617	\$ 71,831,709	\$ 30,757,092	57.2%	\$ 17,753,129	173.25%

Salem Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 6 - MEMBERSHIP EXHIBIT

Retirement in Past Years	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Superannuation	12	16	21	19	16	2	2	15	54	21
Ordinary Disability	2	0	0	1	0	0	0	0	0	2
Accidental Disability	4	1	2	0	0	1	0	3	3	3
Total Retirements	18	17	23	20	16	3	2	18	57	26
 Total Retirees, Beneficiaries and Survivors	 639	 628	 655	 652	 647	 611	 599	 589	 646	 640
 Total Active Members	 778	 795	 890	 811	 865	 895	 909	 924	 839	 883
Pension Payments										
Superannuation	\$3,431,732	\$4,001,226	\$4,222,097	\$4,251,808	\$4,454,116	\$4,459,386	\$4,682,268	\$4,819,607	\$5,532,260	\$6,272,261
Survivor/Beneficiary Payments	559,661	563,549	705,637	703,038	632,453	600,831	472,011	486,663	467,567	464,813
Ordinary Disability	132,496	144,652	155,385	157,768	139,292	166,773	143,724	132,273	125,572	129,197
Accidental Disability	1,699,940	1,085,807	1,183,740	1,156,306	1,143,576	1,283,437	1,272,186	1,334,265	1,438,846	1,488,077
Other	<u>478,684</u>	<u>510,450</u>	<u>506,898</u>	<u>488,918</u>	<u>541,339</u>	<u>576,310</u>	<u>736,371</u>	<u>846,862</u>	<u>741,454</u>	<u>818,390</u>
Total Payments for Year	<u>\$6,302,513</u>	<u>\$6,305,684</u>	<u>\$6,773,757</u>	<u>\$6,757,838</u>	<u>\$6,910,776</u>	<u>\$7,086,737</u>	<u>\$7,306,560</u>	<u>\$7,619,670</u>	<u>\$8,305,699</u>	<u>\$9,172,737</u>

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